

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN	
EXAMINERS' COMMENTS	
SUBJECT Taxation	SESSION Intermediate Examination – Autumn 2013

General

The overall performance was below average. The questions were easy and offered reasonable opportunity of passing the paper. However, the candidates could not come up to the desired level mainly because of inadequate knowledge and because they could not emphasize on the finer points tested in the questions. It was observed that a lot of students had memorized various provisions of the law but did not understand the crux. As in the past, it was also observed that while attempting the questions, the students seemed to disregard the specific requirements of the questions and produced a lot of irrelevant material.

Question-wise comments are as under:

Question 1

This practical question required the candidates to compute salaried individual's taxable income, tax liability and tax payable and carried 21 marks. Although most candidates were pretty much familiar with the tax treatment of various perquisites and allowances but the following mistakes were observed in many scripts:

- Some candidates considered the entire amount of gratuity of Rs. 500,000 as taxable whereas it is exempt upto Rs. 75,000 (gratuity from unrecognized fund is exempt upto 50% of the amount received or Rs. 75,000 whichever is lower).
- Reimbursement of Rs. 100,000 against health insurance policy was considered as taxable, whereas it is exempt under Clause 139(b) of the Second Schedule to the Income Tax Ordinance, 2001.
- Many candidates did not gross up the impact of tax liability borne by the employer.
- Medical allowance is exempt upto 10% of Basic Salary. Some candidates considered 10% of the amount of medical allowance as exempt.
- Rent free furnished accommodation was considered by many candidates as taxable at the annual letting value whereas it is taxed at annual letting value or 45% of Basic Salary, whichever is higher.
- The entire amount of travelling allowance was treated as taxable whereas only that portion which was in excess of expenses actually incurred by the employee should have been included in taxable income.
- Some candidates treated the entire proceeds of Rs. 160,000 (realized on disposal of shares awarded under employee share scheme) as taxable under the head "Salary", instead of classifying Rs. 140,000 (being fair value of shares on the date on which right to sell was established) under the head "Salary" and remaining Rs. 20,000 under Capital Gain.

- In respect of loan of Rs. 400,000 obtained from the employer at a subsidized rate, most of the candidates computed deemed interest and included the same in taxable income whereas according to the relevant provision of the Income Tax Ordinance, 2001 deemed income is recognized only if the loan amount exceeds Rs. 500,000.
- Support payment received from spouse under an agreement to live apart is not taxable. Some candidates included it in taxable income and that too under the head "Salary".
- Donation of Rs. 70,000 to approved organization was incorrectly taken by some candidates as a straight deduction from taxable income instead of claiming tax credit based on average rate of tax.
- A number of candidates did not consider capital gains and related tax thereon in the computation of rebate on donation.

Q.2 (a) This question required the candidates to narrate the conditions for submission of a valid revised return. Many candidates were able to answer this part reasonably well. However, some students used the words 'tax liability' instead of 'taxable profit' and the word 'refund' instead of 'loss declared'. Many candidates also explained the consequences if the revised return is filed after the receipt of notice from the Commissioner which had not been asked.

(b) This part carrying 4 marks required the candidates to comment on the validity of return signed by a tax consultant on behalf of an individual taxpayer, and filing of tax return without discharging the related tax liability. The response was below average as following mistakes were made by a significant number of candidates:

- on the basis of the assumption that the tax consultant was the authorized representative, many candidates incorrectly concluded that he can sign the return also;
- they failed to mention that tax return is considered invalid unless the related tax liability is discharged; and
- they were of the view that Commissioner Inland Revenue (CIR) is empowered to grant extension in payment of any tax liability which is required to be discharged along with filing of tax return. In fact, CIR is empowered to grant extension in payment of tax liability only when it arises from an order or an amended order.

Q.3 (a) This part of the question required the candidates to demonstrate their understanding of the term "Capital asset" as referred to in the Income Tax Ordinance, 2001. Most of the candidates either responded that these are the assets whose useful life exceeds one year or gave the definition of 'Securities' as given in Section 37A of the Income Tax Ordinance, 2001. Some candidates used the term 'any property in kind' instead of the words 'property of any kind'. While explaining the exceptions, instead of mentioning 'property with respect to which a person is entitled to amortization' some students simply mentioned 'intangibles' which was inappropriate because a person cannot claim amortization against every intangible asset.

(b) Understanding of the provisions related to computation of taxable capital gain was tested through this part of the question. The performance was quite poor. The common mistakes in each sub-part are discussed below:

(i) Majority of the candidates failed to appreciate that the immovable property was a depreciable asset and thus specifically excluded from the definition of capital asset; therefore, gain or loss arising on its disposal would not be classified as capital gain.

Many students misunderstood the requirements of the question and explained the provision contained in Section # 22 (13) of the Income Tax Ordinance which states that if consideration received on disposal of immovable property exceeds the cost of asset, the consideration received would be treated as cost of assets.

(ii) Here also, majority of the candidates could not identify that car being a depreciable asset is specifically excluded from the definition of capital asset and therefore, the gain on sale on its disposal would not be classified as capital gain.

(iii) A number of candidates did not know that commission paid to auctioneer shall form part of the cost of antique sculpture. Few candidates did not realize that antique sculpture was retained for more than one year and therefore, only 75% of the gain would be taxable.

(iv) Data pertaining to purchase and sale of three different securities was given. A number of students failed to consider that security 'C' was held for more than one year and thus exempt from tax. Many candidates did not set off capital loss on security 'A' against capital gains on security 'B'. A number of candidates also calculated tax on capital gains, which was not required.

Q.4 (a) This question was based on Section 152(5),(5A) and (6) of the Income Tax Ordinance, 2001 which describes the procedure which a person has to follow if a payment is required to be made to a non-resident without deduction of tax. A number of candidates did not know anything in this regard and resorted to guesswork. Most of those who were able to answer did not explain that the Commissioner is required to pass an order in writing within 30 days of receipt of the application, whether he accepts it or not. Many students reproduced provisions of sub-section (7) of Section 152 which was not the requirement of the question.

- (b) This part contained four different situations where the students were required to explain the residential status of different persons under Income Tax Ordinance, 2001 and Rules made there-under. Majority of the candidates responded well. Comments on each scenario are given below:
- (i) Majority of the candidates correctly answered that Mr. Ramiz was non-resident as his total stay in Pakistan was less than 183 days in tax year 2013. However, some students believed that the requirement is 182 days.
 - (ii) Most of the candidates knew that a government employee is always considered as resident irrespective of his physical presence in Pakistan.
 - (iii) Majority of the candidates were able to identify that Ali Associate is a resident AOP as the management and control of its affairs was partly situated in Pakistan during the year. However, there were some students who believed that as only a part of the control of the AOP was in Pakistan, it would be considered as non-resident.
 - (iv) A number of students considered Smith as short term resident. Some of the students considered him as resident because they included his entire period of stay in Pakistan, for the calculation of residential status for tax year 2013 without appreciating that the period July 1, 2013 to August 31, 2013 falls under tax year 2014.

Q.5 (a) This part required the candidates to differentiate between Public and Private Company for income tax purposes. Many candidates reproduced the definition from the Companies Ordinance, 1984. Other common mistakes were as under:

- Many students used the term more than 50% of the shares held in a company instead of “not less than 50% of the shares held”.
- Some candidates included federal government, provincial government and foreign government in the definition of a public company instead of mentioning that a company in which not less than 50% of the shares are held by these entities, is a public company.
- Many candidates only mentioned unit trust whereas any other trust as defined in the Trust Act, 1882 is also a public company provided its units are widely available to the public. Many students ignored the condition about availability of the units to the public.

In addition to the above, a lot of valuable time was wasted when many students repeated all conditions with a negative, to describe a private company instead of just saying that any company that is not a public company is a private company.

- (b) This part of the question intended to test candidates' knowledge of the procedure for change in tax year and the due date for filing of income tax return if the accounting year end of a Company is changed from June to December. Here again, a lot of mistakes were made, some of which are listed below:
- (i) Majority of the students failed to explain that to be eligible to use special tax year it was important to display compelling need for the change.
 - (ii) Majority of the students did not mention that while granting the permission to use special tax year, Commissioner of Inland Revenue may impose such conditions as he might deem fit.
 - (iii) Some students wrote that application for change in tax year should be submitted to FBR.
 - (iv) Some students were of the view that when the year end of a company is changed from June to December, the period of six months from June to December is to be recognized as transitional tax year.
 - (v) Many students mentioned incorrectly that special tax year should be denoted by calendar year relevant to the normal tax year in which closing date of special tax year falls.
 - (vi) A number of candidates mentioned the due date for filing of tax return as 31st September instead of 30th September. They were not penalized for this mistake but they should try to be more careful.
 - (vii) Many students tried to quote the entire Section # 74 which resulted in wastage of precious time.
- Q.6 (a) This was a scenario based question requiring application of section 87 of the Income Tax Ordinance, 2001 regarding the extent of liability of the legal representative of a deceased individual. Majority of the candidates were able to answer correctly that the legal representative's liability in respect of any tax payable by the deceased individual is limited to the extent of the value of the deceased individual's estate which in the given case was Rs. 7 million. However, there were some who did not understand this apparent logic and incorrectly stated that the legal representative Ahmed is not liable for any liability of his deceased uncle.

- (b) This part required the candidates to comment on the obligation of the legal representative relating to the tax assessment proceedings pending / arising against the deceased individual. The performance of the candidates was just average. The students seemed to have suffered more on account of their failure to carefully comprehend the requirement of the question rather than on account of lack of knowledge. Instead of explaining that any pending proceedings shall continue as if the deceased taxpayer had not died and that any proceedings which could have been initiated against the deceased person could be initiated against the legal representative, many candidates very conveniently stated that the legal representative is liable for tax assessment proceedings pending/arising against the deceased individual. Some students misunderstood the entire question and discussed Section # 140 according to which Commissioner can give notice to a person who owes money to a person or holds money on behalf of a person from whom tax is due.

Q.7 This practical question required the candidates to compute the monthly sales tax liability and the unadjusted input tax to be carried forward to next month. The concepts tested in this question were almost the same as are tested in almost every attempt. The overall performance was good and majority of the candidates were able to secure high marks. However, as usual, the students were unable to handle some of the finer points as discussed below:

- Some students treated the export to Jordan as exempted supply.
- While comparing input tax with 90% of the value of supplies, it is necessary that gross input tax should also include the input tax that has been brought forward from previous month. This point was generally missed by the students.

On the other hand, while apportioning the input tax, some students added the amount of sales tax credit brought forward from the previous period to the current month's input tax credit and apportioned the total amount between taxable supplies and zero rated supplies.

- Many candidates ignored the fact that in case of Soori Limited, the discount allowed was more than the normal discount and therefore, the output tax was to be computed after deducting the normal discount.
- Sales tax penalty was supposed to be added to sales tax payable. Few candidates ignored this while determining sales tax liability; others adjusted it against sales tax refund.
- Some students gave explanatory notes in respect of various situations instead of applying their knowledge in the computation. This approach should be avoided.

- Q.8 (a) In this question the requirement was to state provisions of the Sales Tax Act, 1990 relating to maintenance and retention of records by a registered person making taxable supplies. It was the worst attempted question in which many candidates responded merely on the basis of their general understanding as they seemed to possess little knowledge of the specific provisions contained in the sales tax law.

Following requirements were not mentioned in most of the scripts:

- Records are to be maintained in English or Urdu language;
- Records are to be kept at business premises or registered office;
- Records are to be kept in prescribed form and in such manner that would permit ready ascertainment of tax liability.

Other common mistakes were as follows:

- Some of the students only stated that “records relating to supplies, purchases and imports are to be maintained” instead of identifying the particulars of such records as specified in Section 22 of the Act.
 - Period of retention was mentioned as 5 years instead of 6 years. Moreover, it was not specified as to when the period of 6 years would commence.
 - A number of students mentioned the requirement of keeping record of NTN of suppliers whereas the requirement is to keep record of their sales tax registration numbers.
- (b) This part was based on Rule 18 of the Sales Tax Rules, 2006 relating to filing of electronic return. Generally the performance was good except that some students interchanged the dates of filing of return and the date on which payment becomes due.

(THE END)